

**M e m o r a n d u m****190.0160.325**

To: Mr. Richard Evans  
Ventura District Principal Auditor

Date: May 14, 1987

From: Glenn Bystrom  
Principal Tax Auditor

Subject: H---, SR -- XX-XXXXXX  
Construction contract for a Water Reclamation System

In your memorandum of January 11, 1989, you asked for help in classifying various components in a construction contract as either materials or fixtures or machinery and equipment. Also, you wanted to know what the definition of cost is for the fixtures and if H--- is considered the manufacturer. With you memorandum you provided a diagram of the system showing the items installed by H---, an information pamphlet from H---, a copy of the prime contractor's contract, and a copy of H---' subcontract.

Machinery and Equipment

The components of the water reclamation system will constitute machinery and equipment if the following sequential criteria of Regulation 1521(a)(6) have been met:

1. The property is intended to be used in the production, manufacturing, or processing of tangible personal property not essential to the fixed works (system), building, or structure itself, or
2. The property is intended to be used in the performance of services or for other purposes such as research, testing, or experimentation, which uses are not essential to the fixed works (system), and
3. The property is attached to the realty because of its nature, and it does not lose its identity as a particular piece of machinery and equipment, and
4. If attached to realty is readily removable without damage to the unit or the realty.

I have previously held that the above criteria have not been met if the property is:

- A. Intended as a component part of the whole improvement; or
- B. Part of a system which serves a common purpose for any part of the improvement; or
- C. Attached to the land, building, structure, or system; or
- D. Built into the building, structure, or system, or another fixture.

In other words, the machinery and equipment must be physically and functionally independent of the fixed works, building, structure or system. If it is so attached, the reason for the attachment must relate to the functional nature of the property and its ability to function as a particular piece of machinery and equipment. Accordingly, if it is attached and functions as part of, or in common with, the use or purpose of the improvement, it is not machinery and equipment.

Based on this criteria, it does not appear any of the property installed by H--- in the water reclamation system should be classified as machinery and equipment, since all components are attached and function as a part of, or in common with, the use or purpose of the improvement.

It is my opinion that the components of the water reclamation system should be classified as either fixtures or materials.

#### Fixtures vs. Materials

Two rules have been established which aid in the classification of materials and fixtures. One is that fixtures do not lose their identity when installed and the second is that items which are prefabricated prior to installation are fixtures. Items in which fabrication or installation are inextricably intermingled, are materials. Thus, any item may be classified as either materials or fixtures depending upon the manner in which it is constructed.

It is my opinion that H--- is the retailer of the prefabricated fixtures to which they hold title at the time of installation and are liable for tax on the sales/cost price of these fixtures. H--- is the manufacturer of prefabricated fixtures only to the extent they fabricated or assembled fixtures prior to their installation. Regulation 1521(b)(2)(B) defines how to establish the sales/cost price to be reported by the contractor for fixtures and requires that this price include any job site fabrication labor and its prorated share of manufacturing overhead.

However, any components which are constructed and installed in-place at the job site are treated as materials. This would include materials such as the pipe used to connect fixtures to the fixed works, which are not a part of the fixtures at the time of installation.

Mr. Richard Evans

-3-

February 6, 1989  
190.0160.325

I hope this information is helpful.

GAB:gjm  
0581F

04/21/89

cc: All audit Supervisors  
D. Carroll

# Memorandum

190.0160.325

To: Mr. Glenn Bystrom

May 4, 1996

From: Gary Jugum

Subject: Non-Attorney Opinions

I have reviewed Glenn Bystrom's memorandum of February 6, 1989 to Richard Evans.

We are in agreement with his conclusion, as follows:

**Components of a Water Reclamation System.** The components of the water reclamation system will constitute machinery and equipment if the following sequential criteria of Regulation 1521(a)(6) have been met:

- (1) The property is intended to be used in the production, manufacturing, or processing of tangible personal property not essential to the fixed works (system), building, or structure itself; or
- (2) The property is intended to be used in the performance of services or for other purposes such as research, testing, or experimentation, which uses are not essential to the fixed works (system); and
- (3) The property is attached to the realty because of its nature, and it does not lose its identity as a particular piece of machinery and equipment; and
- (4) If attached to realty is readily removable without damage to the unit or the realty.

The above criteria have not been met if the property is:

- (1) intended as a component part of the whole improvement; or
- (2) part of a system which serves a common purpose for any part of the improvement;  
or
- (3) attached to the land, building, structure, or system; or
- (4) built into the building, structure, or system, or another fixture.

The machinery and equipment must be physically and functionally independent of the fixed works, building, structure or system. If it is so attached, the reason for the attachment must relate to the functional nature of the property and its ability to function as a particular piece of machinery and equipment. Accordingly, if it attached and functions as part of, or in common with, the use or purpose of the improvement, it is not machinery and equipment.

Based on this criteria, the property installed in the water reclamation system should not be classified as machinery and equipment, since all the components are attached and function as a part of, or in common with, the use or purpose of the equipment. Therefore, components of the water reclamation system should be classified as either fixtures or materials. 2/6/89.